

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 SP-02 ICA-11 AID-05 EB-08 SS-15
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INR-10 NSAE-00 XMB-02 OPIC-03 LAB-04 SIL-01 /086 W
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P R 060941Z JUL 78
FM AMEMBASSY BONN
TO SECSTATE WASHDC PRIORITY 9943
DEPARTMENT TREASURY PRIORITY
WHITE HOUSE WASHDC PRIORITY
INFO AMEMBASSY LONDON
AMEMBASSY PARIS
AMEMBASSY ROME
AMEMBASSY BRUSSELS

C O N F I D E N T I A L SECTION 01 OF 02 BONN 12298

USEEC AND USOECD ALSO FOR EMBASSIES
WHITE HOUSE FOR OWEN

E.O. 11652: GDS
TAGS: ECON EFIN GW
SUBJECT: GERMAN ECONOMIC SITUATION AND
PROSPECTS AT THE EVE OF THE SUMMIT

REF: BONN 12256, BONN 10582

1. SUMMARY -- THE POOR MAY ECONOMIC DATA AS WELL AS
THE INTERNAL GERMAN DEBATE ON TAX REDUCTIONS HAVE
INCREASED THE CHANCES OF A GERMAN 1979 PROGRAM OF FISCAL
STIMULUS GOING BEYOND THE ONE PERCENT OF GNP OR DM 12
BILLION RECENTLY MENTIONED BY GERMAN OFFICIALS. A
LARGER RATHER THAN A SMALLER PACKAGE OF TAX REDUCTIONS
AND EXPENDITURE INCREASES MAY IN SOME WAYS ACTUALLY BE
MORE EASY TO PUT TOGETHER POLITICALLY. BUT IT IS AS YET
FAR FROM A SURE THING AS AVERSION TO HIGHER PUBLIC
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DEFICITS REMAINS A SIGNIFICANT COUNTERBALANCE THROUGHOUT
THE POLITICAL SPECTRUM. END SUMMARY.

2. THE JUST RELEASED MAY INDUSTRIAL PRODUCTION AND
ORDER DATA (SEE BONN 12256) HAVE BEEN SURPRISING AND
DISAPPOINTING TO MOST GERMAN ECONOMIC POLICY OFFICIALS
AND OBSERVERS. ON THE BASIS OF SCATTERED QUANTITATIVE

AND QUALITATIVE INDICATIONS MOST OBSERVERS HAVE ASSUMED THAT THE UPSWING WHICH HAD RESTARTED IN APRIL WOULD CONTINUE IN MAY AND LEAD TO A RELATIVELY STRONG SECOND QUARTER MAKING UP AT LEAST SOME OF THE GROUND LOST DUE TO SPECIAL FACTORS (WEATHER, STRIKES, RAPID APPRECIATION OF THE DM) DURING THE FIRST QUARTER. THE MAY DATA NOW INSTEAD SEEM TO INDICATE A NEW HESITATION, STUMBLE OR SLOW-DOWN OF THE ECONOMY.

3. AS EVERYONE HERE IS QUICK TO POINT OUT, GERMAN MONTHLY INDUSTRIAL PRODUCTION AND ORDER DATA HAVE RECENTLY BEEN SUBJECT TO SUCH SIZEABLE REVISIONS A MONTH AFTER THEIR ORIGINAL RELEASE THAT IT IS HAZARDOUS TO BASE TOO FIRM CONCLUSIONS ON THE LAST MONTH'S FIGURE. IT MAY THUS WELL HAPPEN THAT REVISED MAY FIGURES MIGHT BE UPPED CONSIDERABLY AND PRESENT A PICTURE MORE IN LINE WITH PREVIOUS EXPECTATIONS. BUT NO ONE CAN TELL TODAY AND REVISED DATA WILL NOT BE AVAILABLE UNTIL AFTER THE SUMMIT AND PROBABLY ALSO AFTER THE GERMAN CABINET 1979 BUDGET AND FISCAL STIMULUS DECISIONS NOW SCHEDULED FOR THE SECOND HALF OF THIS MONTH.

4. GERMANY WILL THEREFORE BE GOING INTO THE UPCOMING MEETINGS WITH A SOMEWHAT WEAKENED "BARGAINING POSITION" REGARDING THE PROPER AMOUNT OF ADDITIONAL ECONOMIC STIMULUS IT SHOULD UNDERTAKE. FOR IF ONE ASSUMES THAT THE MAY FIGURES WILL STAND -- AND WHO IS TO SAY THAT
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THEY WILL BE REVISED AND, IF SO, IN WHAT DIRECTION -- IT NOW LOOKS VERY UNLIKELY THAT GERMAN REAL GNP WOULD GROW BY MORE THAN 2.5 PERCENT IN 1978 AND IT COULD WELL BE LESS. OUR OWN PROJECTION INDICATES A LIKELY 1978 GNP GROWTH OF ONLY 2.3 PERCENT ASSUMING NO POLICY CHANGES AND NO REVISIONS IN THE MAY DATA. TO REACH EVEN THESE FIGURES, WE ARE ASSUMING A FOUR PERCENT GROWTH RATE (SEASONALLY ADJUSTED ANNUAL RATE OVER PREVIOUS PERIOD) DURING THE SECOND HALF OF THE YEAR AS OPPOSED TO ONLY ABOUT TWO PERCENT DURING THE FIRST HALF.

5. IT PRESENTLY ALSO SEEMS AS IF THE DM 12 BILLION OF ADDITIONAL 1979 GERMAN FISCAL STIMULUS (EXPENDITURE INCREASES AND TAX REDUCTIONS) RECENTLY MENTIONED BY GERMAN OFFICIALS MIGHT BE CLOSER TO THE BOTTOM RATHER THAN THE TOP OF THE RANGE OF WHAT IS POLITICALLY DOABLE. PART OF THE REASON LIES IN THE REDUCED GROWTH OUTLOOK AND THE FURTHER REDUCTION OF THE INFLATION RATE IN JUNE. ANOTHER PART LIES IN THE INCREASED NECESSITY OF THE FDP, AFTER ITS RECENT DISASTROUS STATE ELECTION LOSSES, TO GAIN VOTER APPEAL AS AN EFFECTIVE FORCE FOR TAX REDUCTIONS. FINALLY, IT MAY WELL TURN OUT IN THE END

POLITICALLY EASIER TO PUT TOGETHER A BIGGER RATHER
THAN A SMALLER PACKAGE OF TAX REDUCTIONS AND EXPENDITURE

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INCREASES IN ORDER TO ACCOMMODATE ALL THE FORCES WHOSE
VOTES WILL BE NEEDED IN BOTH THE BUNDESTAG AND THE
BUNDESRAT. WHILE SUCH A BIGGER PACKAGE MIGHT BE SPLIT
INTO TWO PARTS -- ONE FOR 1979 AND ONE FOR 1980 -- AND
MIGHT CONTAIN SOME PARTLY OFFSETTING VALUE-ADDED TAX
INCREASES (PROBABLY IN THE LATER HALF), IT DOES SEEM
MORE LIKELY NOW THAN IT DID EVEN A FEW WEEKS AGO THAT
THE 1979 PART OF THE PACKAGE COULD AMOUNT TO SIGNIFI-
CANTLY MORE THAN DM 12 BILLION. THIS IS NOT YET A SURE
THING, HOWEVER. THE BUNDESBANK CAN BE COUNTED UPON TO
OPPOSE THE INCREASE IN PUBLIC DEFICITS AND MOST GERMANS
WILL FEEL UNCOMFORTABLE WITH THEM. THE CHANCELLOR'S
OWN VIEWS REMAIN UNKNOWN AND IT WILL TAKE SKILLFUL
POLITICAL MANEUVERING TO PUT ANY PACKAGE TOGETHER.

6. THE PROSPECTS FOR TEMPORARY TAX REDUCTIONS THIS
YEAR UNDER THE STABILITY AND GROWTH LAW CONTINUE TO
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BE VERY DIM WITH ALMOST ALL ELEMENTS OF THE POLITICAL SPECTRUM PREFERRING PERMANENT "STRUCTURAL" CHANGES (WHICH WOULD HAVE AN "INCIDENTAL" SHORTER TERM STIMULATIVE EFFECT IN 1979).

7. TO ROUND OUT THE PRE-SUMMIT PICTURE, ONE MONTH MORE DATA DOES NOT SIGNIFICANTLY CHANGE OUR PROJECTION OF THE LIKELY GERMAN CURRENT ACCOUNT SURPLUS (SEE BONN 10582) ALSO IT DOES CALL FOR SOME LARGELY OFFSETTING REDUCTIONS IN THE GROWTH RATE OF BOTH EXPORTS AND IMPORTS COMBINED WITH A SLIGHT DECREASE OF THE SERVICES DEFICIT.

8. OPPOSITION AND SKEPTICISM CONTINUE TO CHARACTERIZE ALMOST ALL PRIVATE AND PUBLIC COMMENT IN GERMANY ON WHAT IS -- ACCURATELY OR INACCURATELY -- LEAKING ABOUT THE SCHMIDT/GISCARD EUROPEAN MONETARY UNION PLANS. STOESEL

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